

of section 305(c). A distribution made by a corporation to its shareholders in its stock or rights to acquire its stock which would not otherwise be included in gross income by reason of section 305 shall not be so included merely because such distribution was made out of Treasury stock or consisted of rights to acquire Treasury stock. See section 307 for rules as to basis of stock and stock rights acquired in a distribution.

(b) *Amount of distribution.* (1) In general, where a distribution of stock or rights to acquire stock of a corporation is treated as a distribution of property to which section 301 applies by reason of section 305(b), the amount of the distribution, in accordance with section 301(b) and § 1.301-1, is the fair market value of such stock or rights on the date of distribution. See *Example (1)* of § 1.305-2(b).

(2) Where a corporation which regularly distributes its earnings and profits, such as a regulated investment company, declares a dividend pursuant to which the shareholders may elect to receive either money or stock of the distributing corporation of equivalent value, the amount of the distribution of the stock received by any shareholder electing to receive stock will be considered to equal the amount of the money which could have been received instead. See *Example (2)* of § 1.305-2(b).

(3) For rules for determining the amount of the distribution where certain transactions, such as changes in conversion ratios or periodic redemptions, are treated as distributions under section 305(c), see *Examples (6), (8), (9), and (15)* of § 1.305-3(e).

(c) *Adjustment in purchase price.* A transfer of stock (or rights to acquire stock) or an increase or decrease in the conversion ratio or redemption price of stock which represents an adjustment of the price to be paid by the distributing corporation in acquiring property (within the meaning of section 317(a)) is not within the purview of section 305 because it is not a distribution with respect to its stock. For example, assume that on January 1, 1970, pursuant to a reorganization, corporation X acquires all the stock of corporation Y solely in exchange for its convertible preferred class B stock. Under the terms of the class B stock, its conver-

sion ratio is to be adjusted in 1976 under a formula based upon the earnings of corporation Y over the 6-year period ending on December 31, 1975. Such an adjustment in 1976 is not covered by section 305.

(d) *Definitions.* (1) For purposes of this section and §§ 1.305-2 through 1.305-7, the term *stock* includes rights or warrants to acquire such stock.

(2) For purposes of §§ 1.305-2 through 1.305-7, the term *shareholder* includes a holder of rights or warrants or a holder of convertible securities.

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§ 1.305-2 Distributions in lieu of money.

(a) *In general.* Under section 305(b)(1), if any shareholder has the right to an election or option with respect to whether a distribution shall be made either in money or any other property, or in stock or rights to acquire stock of the distributing corporation, then, with respect to all shareholders, the distribution of stock or rights to acquire stock is treated as a distribution of property to which section 301 applies regardless of—

(1) Whether the distribution is actually made in whole or in part in stock or in stock rights;

(2) Whether the election or option is exercised or exercisable before or after the declaration of the distribution;

(3) Whether the declaration of the distribution provides that the distribution will be made in one medium unless the shareholder specifically requests payment in the other;

(4) Whether the election governing the nature of the distribution is provided in the declaration of the distribution or in the corporate charter or arises from the circumstances of the distribution; or

(5) Whether all or part of the shareholders have the election.

(b) *Examples.* The application of section 305(b)(1) may be illustrated by the following examples:

Example (1). (i) Corporation X declared a dividend payable in additional shares of its common stock to the holders of its outstanding common stock on the basis of two additional shares for each share held on the record date but with the provision that, at

§ 1.305-3

26 CFR Ch. I (4-1-03 Edition)

the election of any shareholder made within a specified period prior to the distribution date, he may receive one additional share for each share held on the record date plus \$12 principal amount of securities of corporation Y owned by corporation X. The fair market value of the stock of corporation X on the distribution date was \$10 per share. The fair market value of \$12 principal amount of securities of corporation Y on the distribution date was \$11 but such securities had a cost basis to corporation X of \$9.

(ii) The distribution to all shareholders of one additional share of stock of corporation X (with respect to which no election applies) for each share outstanding is not a distribution to which section 301 applies.

(iii) The distribution of the second share of stock of corporation X to those shareholders who do not elect to receive securities of corporation Y is a distribution of property to which section 301 applies, whether such shareholders are individuals or corporations. The amount of the distribution to which section 301 applies is \$10 per share of stock of corporation X held on the record date (the fair market value of the stock of corporation X on the distribution date).

(iv) The distribution of securities of corporation Y in lieu of the second share of stock of corporation X to the shareholders of corporation X whether individuals or corporations, who elect to receive such securities, is also a distribution of property to which section 301 applies.

(v) In the case of the individual shareholders of corporation X who elects to receive such securities, the amount of the distribution to which section 301 applies is \$11 per share of stock of corporation X held on the record date (the fair market value of the \$12 principal amount of securities of corporation Y on the distribution date).

(vi) In the case of the corporate shareholders of corporation X electing to receive such securities, the amount of the distribution to which section 301 applies is \$9 per share of stock of corporation X held on the record date (the basis of the securities of corporation Y in the hands of corporation X).

Example (2). On January 10, 1970, corporation X, a regulated investment company, declared a dividend of \$1 per share on its common stock payable on February 11, 1970, in cash or in stock of corporation X of equivalent value determined as of January 22, 1970, at the election of the shareholder made on or before January 22, 1970. The amount of the distribution to which section 301 applies is \$1 per share whether the shareholder elects to take cash or stock and whether the shareholder is an individual or a corporation. Such amount will also be used in determining the dividend paid deduction of cor-

poration X and the reduction in earnings and profits of corporation X.

[T.D. 7281, 38 FR 18532, July 12, 1973]

§ 1.305-3 Disproportionate distributions.

(a) *In general.* Under section 305(b)(2), a distribution (including a deemed distribution) by a corporation of its stock or rights to acquire its stock is treated as a distribution of property to which section 301 applies if the distribution (or a series of distributions of which such distribution is one) has the result of (1) the receipt of money or other property by some shareholders, and (2) an increase in the proportionate interests of other shareholders in the assets or earnings and profits of the corporation. Thus, if a corporation has two classes of common stock outstanding and cash dividends are paid on one class and stock dividends are paid on the other class, the stock dividends are treated as distributions to which section 301 applies.

(b) *Special rules.* (1) As used in section 305(b)(2), the term *a series of distributions* encompasses all distributions of stock made or deemed made by a corporation which have the result of the receipt of cash or property by some shareholders and an increase in the proportionate interests of other shareholders.

(2) In order for a distribution of stock to be considered as one of a series of distributions it is not necessary that such distribution be pursuant to a plan to distribute cash or property to some shareholders and to increase the proportionate interests of other shareholders. It is sufficient if there is an actual or deemed distribution of stock (of which such distribution is one) and as a result of such distribution or distributions some shareholders receive cash or property and other shareholders increase their proportionate interests. For example, if a corporation pays quarterly stock dividends to one class of common shareholders and annual cash dividends to another class of common shareholders the quarterly stock dividends constitute a series of distributions of stock having the result of the receipt of cash or property by some shareholders and an increase in the proportionate interests of other